

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 02-0499; 02-0500
Indiana Withholding Tax and Corporate Income Tax
For the Years 1993 Through 2000**

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ISSUE

I. Income Received by Out-of-State Manufacturer – Adjusted Gross Income Tax and Withholding Tax.

Authority: 15 U.S.C.S. § 381; 14 U.S.C.S. § 381(a), (c); Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992); IC 6-3-2-1; IC 6-3-2-2(a); 45 IAC 3.1-1-38; 45 IAC 3.1-1-38(4); Schering-Plough Healthcare Products Sales Corp. v. Commonwealth, 805 A.2d 1284 (Pa. Commw. Ct. 2002).

Taxpayer argues that because it is an out-of-state vendor and because its Indiana activities do not exceed the “mere solicitation” standard, it is not subject to Indiana corporate adjusted gross income tax and, for the same reason, it was not responsible for withholding income tax.

STATEMENT OF FACTS

Taxpayer is an out-of-state manufacturer. Taxpayer maintains an Indiana force of four resident sales persons.

In addition, taxpayer has a 79 percent interest in a related, out-of-state company which manufactures tools. Related company does not have an Indiana sales force. Instead, taxpayer's four Indiana salespersons represent both taxpayer and related company in this state. The four salespersons sell both taxpayer's products and related company's tools.

Related company pays taxpayer for the salespersons' services by means of a “cost-sharing arrangement.” According to the audit report, the cost sharing arrangement is “calculated based on a formula originally developed by the taxpayer from the gross sales of the taxpayer and [related company]. The taxpayer is reimbursed through an annual management charge. An intercompany receivable/payable account is used to accomplish the reimbursement. Monies are transferred as the taxpayer deems necessary.”

During the period under audit review, taxpayer did not file Indiana tax returns on the ground that its Indiana activities did not exceed the mere solicitation standard set out in Public Law 86-272.

The Department of Revenue (Department) conducted an audit review of taxpayer's business records and – in short – determined that taxpayer's activities exceeded the mere solicitation standard. The audit review determined that taxpayer should have been paying corporate income taxes during 1990 through 1992 because – during those three years – taxpayer operated as a "C" corporation. The audit review determined that taxpayer should have been withholding individual income taxes on behalf of its shareholders during 1993 through 2000 because – during those eight years – taxpayer was operating as an "S" corporation, and its income flowed directly through to taxpayer's shareholders. Accordingly, the audit review concluded that taxpayer owed additional income and withholding taxes and proposed an assessment of those taxes. The taxpayer disagreed, submitted a protest to that effect, an administrative hearing was held during which taxpayer explained the basis for the protest, and this Letter of Findings results.

DISCUSSION

I. Income Received by Out-of-State Manufacturer – Adjusted Gross Income Tax and Withholding Tax.

IC 6-3-2-1 imposes a tax on the adjusted gross income derived from "sources within Indiana." IC 6-3-2-2(a) provides that adjusted gross income derived from sources within Indiana includes "income from doing business in this state." IC 6-3-2-2(a).

45 IAC 3.1-1-38, in interpreting IC 6-3-2-2(a), provides that for apportionment purposes a taxpayer is "doing business" in Indiana if it operates a business enterprise or activity in Indiana including, but not limited to:

- (1) Maintenance of an office or other place of business in the state
- (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods
- (3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution
- (4) Rendering services to customers in the state
- (5) Ownership, rental or operation of a business or of property (real or personal) in the state
- (6) Acceptance of orders in the state
- (7) Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income.

15 U.S.C.S. § 381 (Public Law 86-272) controls those occasions in which Indiana may properly impose a tax on the net income, derived from sources within that state, on foreign (out-of-state) taxpayers. 15 U.S.C.S. § 381 establishes the minimum standard for the imposition of a state income tax based on the solicitation of interstate sales. Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447, 2453 (1992). 15 U.S.C.S. § 381 prohibits a state from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within that state unless those business activities exceed the mere solicitation of sales. 15 U.S.C.S. § 381(a), (c).

Taxpayer is a foreign corporation and receives money when its four Indiana salespersons sell taxpayer's products to Indiana customers. If taxpayer's Indiana activities were limited to selling its products, taxpayer – and by extensions its shareholders – would not be required to pay income tax because the only associated Indiana activity was the solicitation of the sales. However, taxpayer also receives money from related company when the Indiana salespersons sell related company's tools. In other words, taxpayer receives two streams of income; it receives income from sales of its product and it receives money from related company in consideration of the fact that the taxpayer's Indiana representatives act on behalf of related company.

Taxpayer argues that its Indiana activities are protected by P.L. 86-272 on the ground that its Indiana activities are limited to the solicitation of orders. In support, taxpayer cites to Schering-Plough Healthcare Products Sales Corp. v. Commonwealth, 805 A.2d 1284 (Pa. Commw. Ct. 2002). In that case, the Pennsylvania court found that the out-of-state petitioner was not subject to Pennsylvania net income tax when petitioner's only in-state activities was the solicitation of sales on behalf of its parent corporation. 805 A.2d at 1289. Interpreting the "clear and unambiguous" language of P.L. 86-272, the Pennsylvania court found that, "Congress has simply determined that there is an undue burden on interstate commerce where the only connection with the taxing state by the multistate foreign seller is solicitation of orders by salesmen or foreign contractors." Id.

P.L. 86-272 establishes the minimum standard for imposition of state income based upon solicitation of interstate sales. Wrigley, 112 S.Ct. 2453.

No state shall . . . shall have power to impose, for any taxable year . . . , a net income on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the state; and
- (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such person enable such customers to fill orders, resulting from such solicitation are orders described in paragraph (1). 15 U.S.C.S. § 381(a).

Insofar as taxpayer's representatives solicit sales for taxpayer's own products, P.L. 86-272 plainly protects those particular sales activities because the representatives' activities within this state on behalf of taxpayer consist solely in the solicitation of sales. In addition, there is nothing within the statute which abrogates that protection based upon the cost-sharing arrangement taxpayer entered into with related company. This is not to say that if taxpayer were providing a similar sales service on behalf of an unrelated third-party, that taxpayer would be entitled to the protection afforded under P.L. 86-272. Under such circumstances, taxpayer would plainly be rendering a "service" on behalf of the third-party, and taxpayer would be subject to tax on that

service income. Such is not the situation here; taxpayer is merely soliciting sales on behalf of itself and related company.

During the years at issue, taxpayer's only Indiana activity consisted of the solicitation of sales on its behalf and on related company's behalf. Therefore, the adjusted gross income and withholding tax liabilities should be abated in their entirety.

FINDING

Taxpayer's protest is sustained.

DK/JM/MR – 040104